No. 96-1462

(2)

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IN THE

Supreme Court of the United States

October Term, 1996

CHRISTOPHER H. LUNDING, BARBARA J. LUNDING,

Petitioners,

-v.-

TAX APPEALS TRIBUNAL OF THE STATE OF NEW YORK, COMMISSIONER OF TAXATION AND FINANCE OF THE STATE OF NEW YORK,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

BRIEF OF RESPONDENT COMMISSIONER OF TAXATION AND FINANCE IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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COUNTERSTATEMENT OF QUESTION PRESENTED

Whether this Court should grant certiorari to review a decision of the New York Court of Appeals holding that New York's tax treatment of alimony paid by nonresidents (Tax Law § 631[b][6]) does not violate the Privileges and Immunities Clause of the United States Constitution because substantial reasons exist justifying New York's different tax treatment of alimony paid by residents and nonresidents, including (i) while residents are taxed on their worldwide income, nonresidents are taxed only on their income earned in New York, justifying New York's determination to limit nonresident deductions to those expenses incurred in connection with the production of the New York income, and (ii) alimony payments are intimately connected to the nonresident's personal activities outside New York and are thus allowable as a deduction, if at all, only by the state in which the nonresident taxpayer resides.

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STATEMENT OF THE CASE

This proceeding involves New York State's personal income tax treatment of alimony paid by nonresidents. In 1989, petitioner Christopher H. Lunding was divorced from his spouse

(33)[1]. A separation agreement requiring that he pay his former spouse $108,000 in alimony during 1990 was incorporated into the judgment dissolving the marriage (33). Later in 1989, he married petitioner Barbara J. Lunding (33).

On their 1990 New York nonresident tax return, petitioners reported a federal adjusted gross income of $788,210, including an adjustment[2] of $108,000 for the full amount of alimony paid. They further reported a New York adjusted gross income of $350,488. This sum included an adjustment of $51,934, representing the $108,000 in alimony multiplied by .480868, which was the percentage of Christopher Lunding's 1990 total business income which petitioners reported as derived from or connected with New York sources (20). Relying on New York Tax Law § 631(b)(6) (described below), respondent Commissioner of Taxation and Finance ("respondent") disallowed the alimony adjustment, increasing petitioners' New York source income by $51,934 and their apportionment percentage (described below) from .444663 to .5106. Respondent issued a Notice of Deficiency against petitioners for the resulting tax deficiency of $3,724, exclusive of interest (86-90).

Under New York's personal income tax, nonresidents of the State are liable for tax on only "[t]he net amount of items of

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[1]Parenthetical citations are to the Record on Appeal in the New York Court of Appeals. Parenthetical citations followed by "a" are to the appendix to the petition for certiorari.

[2]The Internal Revenue Code refers to alimony as a "deduction". 26 USC §§ 62(a)(10), 215(a). The New York Tax Law also refers to alimony as a deduction. N.Y. Tax Law § 631(b)(6) (McKinney 1987). Alimony and other deductions listed in 26 USC § 62 (defining adjusted gross income) were also called "adjustments to income" on the 1990 New York State nonresident income tax form filed by petitioners.

income, gain, loss and deduction * * * derived from or connected with New York sources." N.Y. Tax Law § 631(a) (McKinney 1987) ("Tax Law"). A nonresident calculates his New York income tax by first computing a hypothetical tax liability on his total income from all sources determined "as if [he] were a resident" and then multiplying the resulting tax liability "by a fraction, the numerator of which is [the nonresident's] New York source income * * * and the denominator of which is [the nonresident's] federal adjusted gross income for the taxable year." Tax Law § 601(e).[3] This fraction is known as the apportionment percentage. For purposes of computing the numerator of the apportionment percentage, New York source income is not reduced by any nonbusiness deductions. Tax Law § 631(b)(1).

Under New York law, nonresidents include in the calculation of their tax "as if " they were residents all deductions available to New York residents, including the alimony deduction permitted by the Internal Revenue Code, 26 USC § 215. Accordingly, a nonresident is entitled to the benefit of the alimony deduction for purposes of computing the amount of his hypothetical tax liability determined "as if a resident". As to this component of the nonresident's tax computation, the nonresident and the resident are treated alike—both reduce gross income by the amount of alimony paid to determine adjusted gross income ("AGI").

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[3]The quoted language is from Tax Law § 601(e) as in effect during 1990. N.Y. Tax Law § 601(e)(McKinney 1987). Section 601(e) was subsequently amended but the amendments did not substantially change the manner in which a nonresident's New York income tax is computed. N.Y. Tax Law § 601(e) (McKinney 1997 Supp).

However, the Tax Law provides that "[t]he deduction allowed by section two hundred fifteen of the internal revenue code, relating to alimony, shall not constitute a deduction derived from New York sources." Tax Law § 631(b)(6). As a result of such provision, the numerator of the apportionment percentage is New York source income, with no reduction for alimony. Because the denominator of the apportionment percentage is federal AGI, from which alimony has been taken out (26 USC § 62[a][10]), the effect of Tax Law § 631(b)(6) is that the apportionment percentage is greater than it would be if the nonresident were allowed to reduce his New York source income by the amount of alimony paid. Thus, a greater portion of the hypothetical New York tax, determined "as if" the nonresident were in fact a New York resident, is payable as the nonresident's New York income tax liability.

On June 10, 1992, petitioners filed an administrative petition with the Division of Tax Appeals of the Department of Taxation and Finance, contending that Tax Law § 631(b)(6) violated the Privileges and Immunities, Equal Protection, and Commerce Clauses of the United States Constitution (81-90). Respondent duly answered (94-95), and the parties agreed to have the controversy determined without a hearing (80). On April 28, 1994, Administrative Law Judge Thomas C. Sacca (the "ALJ") issued a determination (25a-34a) concluding that the Division of Tax Appeals lacked jurisdiction over facial challenges to the constitutionality of a statute (32a) and denying the petition (34a).

Petitioners filed a notice of exception to the ALJ's determination with the Tax Appeals Tribunal ("the Tribunal") (12-18). They conceded that the Tribunal lacked jurisdiction over challenges to the facial constitutionality of a statute (9). On February 23, 1995, the Tribunal issued a decision affirming the

ALJ's determination (16a-24a). By notice of petition dated June 15, 1995, petitioners commenced the present proceeding challenging the Tribunal's decision pursuant to Tax Law § 2016 (97-109).

In its decision, the Appellate Division followed its earlier decision in *Matter of Friedsam v State Tax Commission*, 98 AD2d 26, 470 NYS2d 848 (3d Dept 1983), *aff'd on other grounds*, 64 NY2d 76, 473 NE2d 1181, 484 NYS2d 807 (1984), and declared that Tax Law § 631(b)(6) was unconstitutional because it violated the Privileges and Immunities Clause of the United State Constitution. 218 AD2d 268, 639 NYS2d 519 (3d Dept 1996) (11a-15a). Accordingly, the court annulled the decision of the Tax Appeals Tribunal (15a). The court did not address petitioners' Equal Protection and Commerce Clause arguments.

Respondent appealed the Appellate Division's decision to the New York Court of Appeals (125-126). In its decision, the Court of Appeals reversed the Appellate Division and held that Tax Law § 631(b)(6) was constitutional. 89 NY2d 283, 675 NE2d 816, 653 NYS2d 62 (1996)(1a-10a). The Court relied on this Court's decisions in *Shaffer v Carter*, 252 US 37 (1920), and *Travis v Yale & Towne Mfg. Co.*, 252 US 60 (1920), where, the Court observed, this Court "established that limiting taxation of nonresidents to their in-State income was a sufficient justification for similarly limiting their deductions to expenses derived from sources producing that in-State income" (5a). The Court acknowledged that a state could not tax the income of nonresidents working in the state while exempting its own residents from tax, *Austin v New Hampshire*, 420 US 656 (1975), nor deny to nonresidents the personal exemption available to residents, *Travis*, *supra* (6a). However, the Court noted that this Court's precedents permitted disparity in tax treatment of

residents and nonresidents "where there are perfectly valid independent reasons for it", *Toomer v Witsell*, 334 US 385, 396 (1948), and that the Privileges and Immunities Clause was not violated where there was a substantial reason for the difference in treatment and the discrimination practiced against nonresidents bore a substantial relationship to the state's objective. *Supreme Court of New Hampshire v Piper*, 470 US 274, 284 (1985) (6a-7a).

The Court found that two relevant substantial reasons justifying different tax treatment of personal nonbusiness expenses incurred by residents and nonresidents had been articulated in the decision of the Appellate Division in *Matter of Goodwin v State Tax Commission*, 286 App Div 694, 146 NYS2d 172 (3d Dept 1955), *aff'd*, 1 NY2d 680, 133 NE2d 711, 150 NYS2d 203 (1956), *appeal dismissed*, 352 US 805 (1956), upholding New York's disallowance of a nonresident's deductions for New Jersey real estate taxes, interest payments, medical expenses and life insurance premiums (7a). First, New York residents, unlike nonresidents, were subject to the burden of taxation on their worldwide income and therefore were entitled to the offsetting benefit of full deductions. Second, the disallowance was appropriate because the expenses were personal expenses of the taxpayer, which were not incurred in connection with the production of the New York income and which were clearly a part of his personal activities in his home state, where the deduction, if any, should be allowed (7a).

Based upon its analysis of the governing law, the Court held that Tax Law § 631(b)(6) did not violate the Privileges and Immunities Clause (8a). The Court found the *Goodwin* court's statement of the substantial reasons justifying the disallowance of nonresidents' personal deductions generally to be equally applicable to the treatment of alimony. The Court concluded

that the disparate tax treatment of alimony paid by nonresidents was fully justified in light of the disparate treatment of income: nonresidents are taxed only on income earned in New York, while residents are taxed on their worldwide income from all sources. According to the Court, the advantage granted residents regarding the alimony deduction is offset by the additional burden of being taxed on their worldwide income. The court noted that, unlike in *Travis* and *Shaffer*, nonresidents "are not denied all benefit of the alimony deduction since they can claim the full amount of such payments in computing the hypothetical tax liability 'as if a resident'" under Tax Law § 601(e)(8a).

The Court also concluded that the disallowance of the nonresident's alimony deduction is substantially justified by the fact that a nonresident's alimony payments are, like the property taxes on an out-of-state residence involved in *Goodwin*, wholly linked to personal activities outside New York having nothing to do with the generation of New York income (8a-9a). Accordingly, the court determined that the approximate equality of tax treatment required by the Constitution was satisfied, and greater fine tuning in New York's tax scheme was not constitutionally mandated (9a).

Finally, the Court determined that the absence of any legislative history regarding the substantial reasons justifying the tax treatment of nonresidents' alimony deductions did not undermine the validity of the statute (9a). The Court found that where, as here, "substantial reasons for the disparity in tax treatment are apparent on the face of the statutory scheme, absence of a statement at the time of enactment will not invalidate the statute" (9a).

REASONS FOR DENYING THE WRIT

The petition for a writ of certiorari in this proceeding should be denied because, *first*, the decision of the Court of Appeals of the State of New York does not conflict with any relevant decisions of this Court and, *second*, the federal question presented in the petition for a writ of certiorari is not an important federal question.

A. The Decision of the New York Court Of Appeals Does Not Conflict With Any Decision of This Court

After an exhaustive and scholarly review of this Court's Privileges and Immunities Clause jurisprudence regarding state personal income taxation, the New York Court of Appeals concluded that New York's income tax treatment of alimony paid by nonresidents does not violate the Privileges and Immunities Clause. This holding comports fully with *Shaffer* and *Travis* and with the cases that follow them. The supposed "clear conflict" with the relevant decisions of this Court, upon which the petition for certiorari is based in part, is simply nonexistent.

As the New York Court of Appeals recognized, this Court's leading precedents governing state income taxation of nonresidents are *Shaffer v Carter*, 252 US 37 (1920), and *Travis v Yale & Towne Mfg. Co.*, 252 US 60 (1920). In *Shaffer*, the taxpayer contended that Oklahoma violated the Privileges and Immunities Clause because it permitted residents to deduct losses wherever incurred but allowed nonresidents to deduct only losses incurred within the state. This Court rejected the contention, stating:

> The difference, however, is only such as arises naturally from the extent of the jurisdiction of the State in the two classes of cases, and cannot be regarded as an unfriendly or unreasonable discrimination. As to residents it may, and does, exert its taxing power over their income from all sources, whether within or without the State, and it accords to them a corresponding privilege of deducting their losses, wherever these accrue. As to non-residents, the jurisdiction extends only to their property owned within the State and their business, trade, or profession carried on therein, and the tax is only on such income as is derived from those sources. Hence there is no obligation to accord to them a deduction by reason of losses elsewhere incurred.

252 US at 57.

Similarly, in *Travis*, decided with *Shaffer*, this Court considered the validity of various aspects of New York's income tax treatment of nonresidents, including a provision which allowed nonresidents deductions only if connected with income arising within New York. This Court found no constitutional impediment to New York's deduction limitation, stating:

> [t]hat there is no unconstitutional discrimination against citizens of other states in confining the deduction of expenses, losses, etc., in the case of non-resident taxpayers, to such as are connected with income arising from sources within the taxing state, likewise is settled by [*Shaffer*].

252 US at 75-76. Accordingly, the Court of Appeals correctly summarized the relevant holdings of *Shaffer* and *Travis* as establishing that limiting taxation of nonresidents to their in-state income is a sufficient justification for similarly limiting their deductions to expenses incurred in producing that in-state income.

Petitioners assert that the decision of the court below conflicts with another aspect of *Travis*, which did not address the denial of nonresidents' deductions for expenses incurred but instead invalidated New York's denial of personal exemptions to nonresident taxpayers. 252 US at 77-82. This Court found that the denial of the personal exemptions violated the Privileges and Immunities Clause, because whether the nonresident taxpayers "must pay a tax upon the first $1,000 or $2,000 of income, while their associates and competitors who reside in New York do not, makes a substantial difference" for which this Court found no adequate justification. 252 US at 80.

Petitioner's assertion that the decision of the court below conflicts with this aspect of the *Travis* decision is misplaced. This Court saw no inconsistency in its holding validating New York's disallowance of nonresident deductions for expenses unrelated to New York income while at the same time striking down New York's disallowance of the nonresident personal exemptions. Deductions represent allowances for expenses actually paid or incurred, whereas personal exemptions immunize a portion of a taxpayer's income from liability solely on the basis of his personal status and without regard to any expenses he might have incurred. *See*, Hellerstein, *Some Reflections on the State Taxation of a Nonresident's Personal Income*, 72 Mich L Rev 1309, 1343 (1974). Accordingly, the justification articulated by this Court in *Shaffer* and *Travis* for limiting a nonresident's deductions to those incurred to produce the in-state income subject to tax, and relied upon by the court below in sustaining the disallowance of petitioners' alimony deduction, did not justify the disallowance of the personal exemptions at issue in *Travis*. However, such justification clearly supported the decision of the court below. Contrary to petitioner's argument, this Court's reasoning in *Travis* invalidating New York's denial of the nonresident personal exemptions

is inapplicable here. Rather, as the court below found, the *Travis* holding relevant to this proceeding is the holding validating New York's denial to nonresidents of deductions for expenses not connected with the production of their New York income.

Similarly, the decision below does not conflict with this Court's decisions in *Ward v Maryland*, 79 US 418 (1870), and *Austin v New Hampshire*, 420 US 656 (1975). In *Ward*, this Court struck down a Maryland merchant licensing scheme that imposed substantially higher license fees on nonresident merchants than on those resident in the state. In *Austin*, this Court invalidated New Hampshire's commuter income tax which had the effect of taxing only the income of nonresidents working in New Hampshire. In *Austin*, this Court stated that the Privileges and Immunities Clause requires "substantial equality of treatment" between residents and nonresidents and noted that the burden on New Hampshire nonresidents was not offset even approximately by other taxes imposed on residents alone. 420 US at 665.

By contrast, in this proceeding, the court below determined that the advantage granted New York residents regarding the alimony deduction was offset by the additional burden of being taxed on their worldwide income (8a). This fact, and the fact that petitioners' alimony payments were personal expenditures completely unrelated to the generation of their New York source income, provided the substantial equality of tax treatment mandated by the Constitution.

B. The Question Presented Is Not an Important Federal Question

Petitioners assert that the question presented is an important federal question because of the number of taxpayers claiming the federal alimony deduction provided by 26 USC § 215 (Petn, 11). However, New York's income tax treatment of alimony paid by nonresidents is consistent with the approach adopted by the Internal Revenue Code, which completely denies the alimony deduction to nonresident aliens. 26 USC § 873(a) (deductions limited to those connected with income that is effectively connected with a US trade or business); 26 USC § 871(a)(1) (US-source income not effectively connected with a US trade or business is taxable at a flat rate with no deductions). Moreover, petitioners do not specify the number of taxpayers who would be eligible to claim an alimony deduction on nonresident state income tax returns filed in states limiting the deduction to residents only. Indeed, petitioners point to only one other decision of a state court of last resort involving the disallowance to nonresidents of the alimony deduction allowed to residents.

In *Wood v Department of Revenue*, 305 Or 23, 749 P2d 1169 (1988), the Supreme Court of Oregon held that Oregon's denial of the alimony deduction to nonresidents while allowing the deduction to residents violated the Privileges and Immunities Clause. Like the New York deduction disallowance upheld by this Court in *Travis*, the Oregon statute generally limited a nonresident's Oregon deductions to those incurred in connection with the Oregon-source income. 305 Or at 26, 749 P2d at 1170, n 3. The court analogized the denial of an alimony deduction to the denial of the personal exemptions that this Court invalidated in *Travis* and found no substantial reason for the different treatment. 305 Or at 31, 749 P2d at 1173. New York's tax

treatment of alimony is somewhat distinguishable from the Oregon statute at issue in *Wood* because, as the court below observed, New York nonresidents are not denied all benefit of the alimony deduction since they can claim the full amount of alimony payments in computing the hypothetical tax liability "as if a resident" to which the apportionment percentage is applied. Nevertheless, the holding of the court below is in conflict with the *Wood* decision.

Wood is the only decision of a state court of last resort cited by petitioners specifically involving alimony which directly conflicts with the decision below. The only other decision of a state court of last resort cited by petitioners, *Spencer v South Carolina Tax Commission*, 281 SC 492, 316 SE2d 386 (1984), *aff'd by an equally divided Court*, 471 US 82 (1985), does not involve alimony. In *Spencer*, the Supreme Court of South Carolina invalidated that State's disallowance all of a nonresident's nonbusiness deductions unless the state of the taxpayer's residence permitted similar deductions to its nonresidents. The *Spencer* decision did not analyze this Court's decisions in *Shaffer* and *Travis* in reaching its conclusion that the South Carolina statute violated the Privileges and Immunities Clause. This Court affirmed the South Carolina Supreme Court decision only on an unrelated issue regarding attorneys' fees. *Spencer v South Carolina Tax Commission*, 471 US 82 (1985), Petition for a Writ of Certiorari to the Supreme Court of South Carolina, at (I) ("Questions Presented").[4]

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[4]Petitioners do not mention the decision of the Supreme Court of Nebraska in *Anderson v Tiemann*, 182 Neb 393, 155 NW2d 322 (1967), *appeal dismissed*, 390 US 714 (1968), upholding against a Privileges and Immunities Clause challenge that State's allowance of a food sales tax credit only to residents on the ground that food purchases for personal use are so closely

(continued...)

Accordingly, an issue that has been specifically considered by state courts of last resort only once previously in the history of the Republic, and that is presented in a case involving only $3,724 in disputed tax, is not of sufficient importance to merit review by this Court.

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[4](...continued)
related to the state of residence that any credit should be allowed only by such state. Like *Spencer*, such decision did not specifically address alimony. However, the analysis of the Nebraska Supreme Court is consistent with that of the court below.

CONCLUSION

THE PETITION FOR A WRIT OF CERTIORARI SHOULD BE DENIED.

Dated: Albany, New York
April 14, 1997

Respectfully submitted,

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